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# DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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Renaissance. Periodically, after crucial and unexpected turns in the market, the study of the Dow Theory gains renewed attention from the public. Because a handful of Dow Theorists and very few others correctly interpreted last year's reaction and also predicted this year's historic advance, a good deal of interest has been revived in this oldest and most dependable method of forecasting price movements and economic trends.

INFALLIBILITY. The Dow Theory is not a "system" for beating the market. As far as I know no such system has ever been invented. Nor would the development of an infallible system be in the public interest. For on the day that such a method is perfected the market will cease to exist. Within a short period of time the inventor of the perfect system would corner the free world's supply of money. The Dow Theory is subject to the art of interpretation. Because a great deal of study, knowledge, and ability must go into correct interpretation, the Theory has suffered at the hands of a large number of dabblers. It was one of the purposes of these letters to present Dow's Theory as I thought it was presented by earlier and more studious writers.

My original experience in the stock market was as an "in-and-out" trader. After many losses, I decided either to make sense of the market or take permanent leave. After studying every service, theory, and system that I could lay my hands on, I hit upon Dow's Theory. Realizing that it is not infallible, I believe it is the only system that actually does predict the trend of the market. The Wall Street adage says, "The charts are excellent, it's the chartists who are no good." There is sad truth in this. Yet Robert Rhea once remarked that he never met a man who, once having fully understood Dow Theory, ever abandoned his studies. The author agrees fully and is still studying.

PAST PERFORMANCE. A few services regularly print a list of stocks which they supposedly "hold." These are the so-called "model accounts." The theory is that had one followed the advice of these services, he would show the same type of profits that these "model accounts" show. On closer study, one finds that these accounts are theoretical as far as actual investment in money is concerned--they do not represent cold, hard cash! The following words are from a Wall Street Journal editorial by Charles H. Dow:

> "Almost any man can show profits in stock by assuming that he would do so and so at various conditions of the market. He succeeds theoretically in this way because there is nothing at risk and his judgement is clear. The moment, however, that he has a risk that is very large in proportion to his capital, he consults his fears instead of his judgement, and does in practice exactly opposite what he would have done had his transactions been purely academic."

QUESTIONS. The author will attempt to answer any questions submitted to him which he feels will be of general interest to readers. I regret that time does not permit my answering questions pertaining to personal affairs or individual securities.

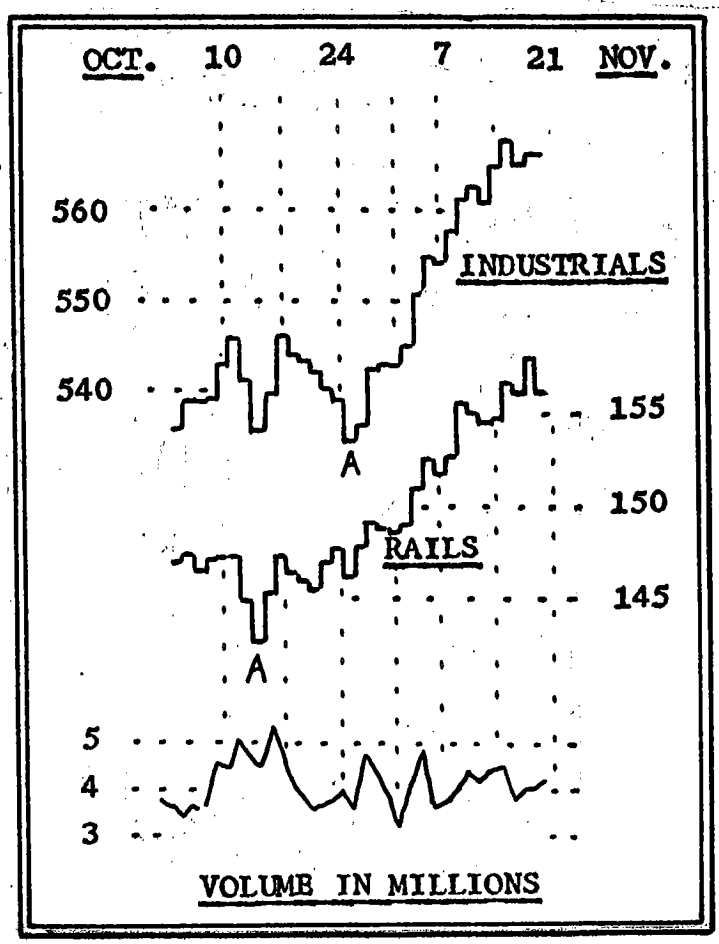
BULL SIGNALS. When on a decline in a bull market, one or both averages refuse to go below their previous decline levels--and both averages then advance over their previous highs a "bullish signal" is given. This signal says that the situation remains bullish and that in all probability a further advance will ensue. These "bullish signals" should be distinguished from primary bull signals. A primary bull signal is given when both averages--following a reaction, advance to new highs for the entire bull market. The simultaneous penetration of bull market highs by both averages is considered the most reliable forecasting signal that

we possess under Dow Theory. Although simultaneous penetration (on the same day) is not necessary, it is considered a more urgent bull signal than confirmation on separate days.

THE NEXT PRIMARY BULL SIGNAL. In 1956 rails and industrials hit their bull market highs of 181.23 and 521.05 respectively. On the severe 1957 reaction, rails declined to 95.67 and industrials to 419.79. Since then we have had a series of bullish signals as both averages plotted a long upward course with previous highs continually broken all the way up. Recently industrials gave their half of a primary bull signal by breaking their bull market (521.05) and all time highs. The rails (now at about 157) still have not confirmed by going through their 181.23 highs of this bull market. The Dow Theory masters were specific in saying that if one average gave a primary bull signal and the other average followed "in gear" or in direction, bullish inferences could be drawn. There is no time limit placed on the confirmation part of the Dow Theory. The rails may now confirm in a week, a month, or a year. This writer is convinced that the rails will confirm in due time and is operating as if a primary bull signal was "in the cards." A few shallow "Dow Theorists" insist that the rails must confirm the industrial highs (by making a bull market high of their own) before we can be sure that we are still in a bull market. Rhea and Hamilton acted many times in this same situation on the assumption that a primary bull signal would eventually verify bullish inferences previously drawn. It is possible that when a rail bull signal is finally given this bull market will be largely completed. Those who waited for the orthodox primary bull signal will then have missed the better part of a very profitable advance.

DOW THEORY. Since October 27, industrials have risen in a straight-up advance of 30 points. Rails have advanced "in-gear" with industrials for a beautiful 15 point gain. Readers should be aware that the rail average now sells for one-quarter that of the industrials, so that the 15 point rise in the rails equal 60 points in the industrials. Actually, percentage-wise, the rail move has been fully twice that of the industrials. It was not many months ago that Congress and the country were bemoaning the fate of the dying carriers. The recent rail formation, as noted in last week's letter, is a more bullish structure than that of the industrials. The comparatively greater rail move in the last week would seem to bear this out.

After perpendicular rises such as we have witnessed in the last month, it is perfectly normal for a sharp decline to correct at least 1/3 to 2/3 of the rise since the October lows (point A on chart). But volume indications seem to belie this possibility for the present. On any sign of weakness, volume drops sharply, seeming to say that there is little selling to be done. The short interest announced Wednesday is once again a perfectly incredible figure! There has been less than a 3% drop in the short position after a rise of 30 points in the industrials in the last month. The stony refusal of 5 million shorts to run for cover may well herald a giant year-end rise as the stubborn shorts buy to protect further losses.




STOCKS TO BUY. The following stocks are in a strongly bullish technical pattern and may be bought on any weakness. A.M.F. INDUSTRIES, PIPER AIRCRAFT, UNIVERSAL CYCLOPS, FREUHAUF TRAILER, AMERICAN BOSCH, STANDARD OIL OF CAL., TEXAS CO., U.S.STEEL, MACK TRUCK, POLAROID, CELANESE. Stock of the week: STONE and WEBSTER.